

Lithuania: Financing of warehouse receipts: Legal review

Lithuania

Please address comments and inquiries to:

**Investment Centre Division
Food and Agriculture Organization of the United Nations (FAO)**

Viale delle Terme di Caracalla - 00100 Rome - ITALY
Telephone: (+39) 06 57 05 53 18
Fax: (+39) 06 57 05 46 57
E-mail: investment-centre@fao.org
Web site: www.fao.org/tc/tci/tci.htm
FAO Web site: www.fao.org

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Legal review



Food and Agriculture Organization
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European Bank
for Reconstruction and Development

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FINANCING OF WAREHOUSE RECEIPTS / LEGAL REVIEW

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Currency Equivalents

(2002)

US\$ 1 = BGL 1.9

US\$ 1 = LTL 3.5

US\$ 1 = HUF 234.2

US\$ 1 = EUR 1.0

Abbreviations

BGL	Bulgarian Leva
EBRD	European Bank for Reconstruction and Development
EUR	Euro
FAO	Food and Agriculture Organization of the United Nations
HUF	Hungarian Forint
LTL	Lithuanian Lita
US\$	United States Dollar
VAT	Value-Added Tax

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Twelve representatives of selected Lithuanian governmental institutions participated in the study tour to Hungary and Bulgaria, which took place between 20 and 25 May 2002. The tour was organised by Stjepan Tanić (Farming System Development Officer, FAO) and Vlaho Kojaković (Economist, FAO), with the precious assistance of Rimantas Purtulis (Senior Banker, EBRD). The programme of the tour is attached in Annex 1.

FAO would like to thank the representatives of the Ministry of Agriculture and Forestry of Bulgaria, the Bulgarian National Grain Service Authority, the SG Express Bank and the Union Bank of Bulgaria for their kind participation. In Hungary, FAO would like to thank the Agricultural Market Regulation Office and the Department of Economics of the Ministry of Agriculture and Regional Development, the Ministry of Economy, the Agrarian Intervention Centre, Kereshedelmi és Hitelbank and Concordia Warehouse Ltd. Finally, FAO would like to express his gratitude to all Lithuanian officials that participated in the study tour and to Vaidotas Puklevicius, Lawyer, who prepared this report.

1. INTRODUCTION

1.1 Warehouse receipts are used to facilitate the financing of primary agriculture, agricultural trade and food processing. By storing grain or other agricultural commodities in licensed warehouses, farmers, traders and agri-processors have the possibility to obtain receipts that can be used as collateral with local credit institutions. This system has proved particularly useful in Central and Eastern European countries where agricultural enterprises do not have strong credit histories and have few assets to pledge as collateral. In these circumstances, local banks often prove reluctant to lend to the agricultural sector. For warehouse receipts to become a convincing instrument to secure loans to agricultural enterprises, a coherent institutional and regulatory framework is required. Banks need to be able to trust warehouses, which should be licensed and supervised properly, and banks must be certain that the receipts can be used as effective deeds to exercise their rights in case of loan default.

1.2 The European Bank for Reconstruction and Development (EBRD) has promoted the development of such institutional and regulatory frameworks throughout the region, in particular in Bulgaria, the Slovak Republic and the Russian Federation. In these countries, as well as others, the EBRD has also financed credit institutions wishing to use grain warehouse receipts to secure their loans to local agricultural enterprises.

1.3 Like in other countries of the region, agricultural enterprises in Lithuania are facing difficulties in raising working capital. In this context, the EBRD has decided to promote the development of a grain warehouse receipt programme in this country. To achieve this, the EBRD has called upon the assistance of the Food and Agricultural Organization of the United

Nations (FAO), under the cooperation agreement that exists between the two institutions.

1.4 The programme of assistance commissioned by the EBRD had two main objectives:

- transfer the experience and knowledge of Central European countries in the area of grain warehouse receipts; and
- analyse the existing legislative framework in Lithuania with a view to identifying areas for improvement in order to utilise warehouse receipts in agricultural lending.

1.5 For the first part of the project, the FAO organised a study tour for twelve representatives of selected Lithuanian governmental institutions. During the study tour, the Lithuanian officials visited their counterparts in Hungary and Bulgaria, with whom they could share experiences in the area of warehouse receipt financing. Warehouse receipt programmes are successfully implemented in these countries and this allowed a practical and fruitful exchange of information between the Hungarian and Bulgarian officials and their Lithuanian counterparts. It is expected that these contacts will continue in the future.

1.6 The second part of the project consisted of reviewing the existing legislative environment in Lithuania with respect to the utilisation of warehouse receipts as collateral and putting forward recommendations for improvements. The analysis was carried out by a Lithuanian legal expert and is presented in this document.

1.7 Further to this exercise, the EBRD is currently exploring the possibility of extending a small credit line to a local bank in Lithuania for lending against warehouse receipts.

2. ANALYSIS OF THE LEGISLATIVE ENVIRONMENT FOR THE FINANCING OF WAREHOUSE RECEIPTS IN LITHUANIA

Present lending practices using agricultural commodities as collateral

2.1 Currently in Lithuania, banks and other credit institutions tend not to accept agricultural commodities as collateral for funds extended to farmers. Mortgage of real estate and machinery are preferred over agricultural commodities largely due to the complicated system of debt recovery in the event of default. Once funds have been lent, however, commodities such as cheese and butter (rather than grain or other similar products) often do stand as collateral.

The existing legislative framework for lending against agricultural commodities, collateral policies and industry practice

General

2.2 The main legal act regulating lending activities is the Civil Code, which came into force on July 1, 2002, and the Law on Collateral as amended on March 19, 1998; these laws will continue be to in effect until the year 2003. As of January 1, 2003, a new Code on Civil Proceedings will replace the previous legislation.

2.3 According to the existing legislation, the pledge agreed at the time the loan is made shall be movable items or property rights that secure the fulfillment of the present or future liability. A pledged object may be transferred to the creditor or third party or left in the possession of the pledger. In the latter case, the object of pledge may be locked, sealed, or marked to show that it has been pledged. The creditor shall have the right of

priority to satisfy any claim from the value of the item pledged upon non-discharge by the borrower of his/her obligations secured by pledge.

2.4 Pursuant to Lithuanian legislation, any movable items (including agricultural commodities), as well as property rights, may be objects of pledge.

Pledge agreements and registration

2.5 The pledge agreement (pledge bond) shall specify the following:

- Place and time of execution.
- Pledger, borrower, creditor, and person to whom the object of pledge is to be transferred.
- Domicile (or registered office) of the foregoing persons.
- Description of the item to be pledged or of the property rights concerned, with a valuation and statement of location.
- Details of the liability to be secured by the pledge, including interest, specific or maximum amount, and date of fulfillment.

2.6 It should be noted that, for the time being, pledge agreements (pledge bonds) are required to be executed using a special form approved by the Ministry of Justice, and must be certified by a public notary. Moreover, according to the Law on Collateral, all pledges must be registered with the Hypothecation Court. Secured liabilities are discharged

subject to a hypothecation bond produced for this purpose. The borrower may withhold discharge of his/her liabilities if the hypothecation bond is not presented by the creditor. Therefore, it follows that no collateral will be valid unless registered with the Hypothecation Register.

Subsequent pledges and claim priority

2.7 Unless an item is transferred to the pledgee by a senior (previous) pledge, or the pledge bond provides otherwise, any subsequent pledge shall be allowed when the object of the pledge has not been transferred to the pledgee. In such cases the previous pledge shall remain in full force and effect. The pledger shall be required to notify each creditor of all previous and subsequent pledges, and also of the obligations secured by these pledges including the amounts thereof. The pledger shall be required to compensate for losses sustained by any creditor as a result of non-discharge of these obligations.

2.8 If several pledge bonds are registered for one and the same item, priority shall be given to claims secured under registered pledge bonds on the basis of seniority of the application filed. Claims of subsequent creditors shall be satisfied only upon full satisfaction of the claims of senior creditors.

Recovery

2.9 A pledgee shall acquire the right to direct any recovery of the object of pledge if the obligation has not been discharged upon the expiry of the obligation fulfillment term. However, this right shall not be acquired earlier than twenty days after the expiry of the obligation fulfillment date.

By agreement of the parties, another fulfillment term may be set, but such a term shall not be less than ten days.

2.10 A creditor shall be entitled to claim an obligation secured by a pledge before the end of the fulfillment term, if:

- any other person directs recovery of the item pledged;
- the pledger dies or a liquidation procedure is initiated against the pledger by a legal entity;
- an item pledged has been destroyed or has decreased in value by more than 30 percent due to reasons beyond the control of the pledger;
- the pledger prevents the creditor from inspecting the state of the item pledged;
- the conditions of the contract regarding any subsequent pledge are breached, or in the case that the pledger has violated other contractual conditions, or performed actions that may result in a decrease in value of the item pledged or the recovery becoming non-realizable.

2.11 In the event that the borrower fails to discharge his/her obligation as secured by the pledge, the creditor's claim shall be satisfied from the value of the item pledged unless the law or contract provide otherwise.

2.12 The creditor shall be required to notify the borrower and the pledger (when the pledger is a party other than the borrower) in writing that recovery will be initiated in the case of failure to discharge the obligation secured by pledge within the term specified by the law. If the pledge is registered with the mortgage register, a written notification shall be served to the borrower through the mortgage institution, and that institution shall be required to inform any other persons listed in the mortgage register who have the right to the item that is subject to recovery.

2.13 The pledger, upon receipt of the recovery notification, shall not be entitled to sell, lease or otherwise encumber the rights to the said item to any party other than the creditor, and the item pledged shall then be transferred to the creditor. If the pledger fails to transfer the item pledged to the creditor, the creditor may involve a mortgage judge to enforce transfer of the pledged item to the creditor. The creditor shall sell the item pledged in the manner agreed upon by the creditor, borrower, and the pledger (when the pledger is a party other than the borrower), or ownership of the item pledged shall be transferred to the creditor by a joint agreement. Failing such an agreement, the item shall be sold by auction. If the item has been pledged to multiple creditors, it may be transferred to the sole ownership of one of the creditors upon the agreement of all the creditors. The securities pledged shall be realized by the creditor following the procedure established by law. Upon sale of the item pledged, the funds received shall be transferred to the mortgage institution concerned and distributed following the requirements established by the Code of Civil Proceedings. If the amount received after the sale of the item pledged is not sufficient to satisfy the pledger's claim in full, the pledgee shall, unless the law or the contract provides otherwise, have the right to recover the remaining amount

from the other assets of the borrower. In this case, the pledgee shall not have pre-emption rights over the other creditors.

Special legal provisions with respect to the storage and release of goods and warehouse documentation

General

2.14 The Lithuanian Civil Code in force at present sets general rules on custody and special legal rules on safekeeping, warehousing and warehousing documentation. On the basis of a warehousing contract, the warehouse (the custodian) undertakes to receive into custody the goods entrusted to it by the owner of goods (the client) and to return the same to the aforementioned person. A warehouse shall be recognized to be a common-use warehouse if, under law or according to its own business documents, it is required to accept goods into custody from any owner of those goods. A contract on the warehousing of goods in a common-use warehouse is qualified as a public contract. Thus, it can be seen that although the Lithuanian Civil Code provides special rules on warehousing, they are of too general a nature to regulate the warehousing of different groups of goods properly, and to deal in sufficient detail with any questions that may arise in practice. In order to implement the system of storage of agricultural commodities as collateral (including grain), a special law is required to regulate their warehousing, and the financing of the associated warehousing receipts, as well as any linked secondary legislation deemed necessary. Because of the current lack of this special legislation (which is presently at the draft stage, see Section 3.1.), the existing legal rules with respect to warehousing are not, in general, applied to the storage of agricultural commodities as collateral, although this is referred to in the provisions of the Civil Code.

Warehousing documents

2.15 Following the Civil Code, a warehouse that has taken goods into custody shall issue one of the following documents confirming the warehousing contract:

- a double warehousing certificate;
- an ordinary warehousing certificate; or
- a warehouse receipt.

2.16 The double warehousing certificate shall consist of two parts – a warehousing certificate, and a pledge certificate – which may function separately. The goods taken into custody under the double warehousing certificate, provided that it consists of separate parts, or under the ordinary warehousing certificate (which has no associated pledge certificate), may be encumbered with a charge during the custody period by pledging a relevant certificate.

2.17 Each part of the double warehousing certificate shall specify the following:

- name and location of the warehouse;
- number of the warehousing certificate;
- name and registered office of the owner (the client) of the goods in storage;
- name and quantity of goods (units, weight, volume, etc.) and the pledge amount;
- term of custody of goods or indication that they are kept in custody until called for;

- amount of service charge or tariffs based on which the service charge is calculated, and the payment procedure; and
- date of issuance of the warehousing certificate.

2.18 A double warehousing certificate (i.e., a warehousing and pledge certificate) shall be a document evidencing the right of ownership, and entitling the holder to dispose of the goods in storage. A holder of a warehousing certificate, as detached from the pledge certificate, shall have the right to dispose of the goods, but is not entitled to collect them from the warehouse until repayment of the credit, since the repayment is secured by the pledge certificate.

2.19 A holder of a pledge certificate shall have the right of pledge with respect to the goods, the value whereof equals the amount of the credit and interest thereon. When pledging the goods, this right shall be recorded in the warehousing certificate. A warehousing and pledge certificate may be transferred to another person, together or separately, according to the entries of transfer that have been endorsed.

Release of goods according to the double warehousing certificate

2.20 A warehouse shall release the goods to the holder of the double warehousing certificate only upon receipt of both parts of this certificate. The goods shall be released to the holder of a warehousing certificate who, although he/she possesses no pledge certificate, has repaid the whole debt according to the terms of the pledge agreed, only upon submission to the warehouse of the warehousing certificate and the document evidencing repayment of the debt.

2.21 A holder of a warehousing and pledge certificate shall be entitled to claim goods in portions. In such cases new certificates for the remaining portion of the goods in store shall be issued, instead of giving back the original certificates.

Past and present legislative initiatives related to warehouse receipts and the likelihood of these being developed further

2.22 The Lithuanian Ministry of Agriculture has, for almost one year, been working on the Law on Warehouses and Warehouse Receipts. The draft law has been submitted to various governmental institutions (namely, the Ministry of Finance, the Ministry of Justice, the Ministry of Economy, the State Grain Inspectorate, the Department of European Law), to different public organizations (namely, the Farmers Association, the Association of Grain Processors), and to commercial banks (AB Vilniaus bankas, AB Hansa-LTB) for comments and proposals.

2.23 The Ministry of Agriculture, having considered the resulting comments and proposals, has submitted the draft law to the Government, and to the Ministry of Justice, for final review. After the draft law is approved by the Government, it will be presented to the Seimas (the Parliament) for discussion and consideration by its various internal committees and for final approval. An analysis of this draft law is given later in this report (see Sections 3.2. –3.4.).

2.24 The secondary legislation required will be implemented upon the approval of the draft law.

Taxation of warehouse receipts

2.25 Generally, warehouses as legal entities must pay profit tax as established by the Profit Tax Law effective as of January 1, 2002. The tax base of a warehouse encompasses all the income earned in Lithuania and abroad. The taxable profit earned by a warehouse is subject to the general 15 percent rate of tax. Any fees received are subject to 18 percent value added tax (VAT), which will be refunded to clients who are VAT payers.

Legal precedents related to the utilization of warehouse receipts as collateral

2.26 We have no knowledge of any precedents related to the utilization of warehouse receipts as collateral.

Conclusion

2.27 Even though Lithuanian legislation establishes certain rules with respect to warehouse receipts, the implementation of the system in practice requires that special laws with secondary legislation be approved.

3. ANALYSIS OF THE CURRENT LEGAL FRAMEWORK FOR THE FINANCING OF WAREHOUSE RECEIPTS IN BULGARIA AND HUNGARY

3.1 This section of the report is based upon knowledge gained during the visits of a Lithuanian delegation to Bulgaria and Hungary, undertaken to investigate the financing of warehousing receipts in those two countries.

General

3.2 Bulgaria started a program of warehouse receipts in 1998 with a set of endeavors aiming at creating primary and secondary legislation, establishing a government regulatory agency, and analyzing the benefits of using such system for grain producers, grain processors and bankers. Currently, there are approximately 20 licensed public warehouses and financial institutions that have extended loans for over USD 3.5 million.

3.3 Hungary has made the most significant progress in the development of a warehouse receipts system in the Eastern Europe. The law approved in 1996 covers various agricultural commodities such as wine, sugar, fertilizers, and cigarettes, although it has mainly been applied with respect to the financing of grain exports. A large spectrum of commercial banks is involved in the Bulgarian public warehousing system.

Existing legislative framework

Bulgaria

General

3.4 Thirty-five licensed warehouses are currently functioning in Bulgaria. A warehouse intending to obtain a warehousing certificate is required to have at least 3000 tons of warehousing capacity. A licensed warehouse has to provide a farmer with a fixed-form document for delivery of grain into custody. This document shall be composed of two parts, which are practically inseparable. A grain producer may be extended a short-term credit for grain kept in a licensed warehouse, i.e., 70–80 percent of the value of the grain in store, based on the market price established on the National Grain Exchange. To enhance the system, the state allocates approximately BGL 14 million each year. A part of the warehousing costs and the interest on short-term bank credits are reimbursed to the grain producers out of these government funds. A Compensation Fund of licensed warehouses has been formed in Bulgaria with the purpose of compensating the farmers and the bank for such losses due to fraud or deception, which is not covered by standard insurance. A warehouse wishing to join the Fund must pay an admission fee of BGL 200. A farmer who has been extended a short-term credit against pledged grain must transfer BGL 0.36 to the warehouse's account for each ton of grain stored, and the warehouse, in turn, transfers this amount to the Compensation Fund.

3.5 In 2000, the commercial bank AB Union Bank began extending short-term credits to farmers who keep grain in licensed warehouses. In that year, the bank allocated EUR 1.0 million for this purpose. In March 2001,

the European Bank for Reconstruction and Development (EBRD) extended a tied credit to AB Union Bank of EUR 1.5 million. AB Union Bank disbursed EUR 4.0 million to credits for farmers in 2001–2002, out of which amount EUR 2.5 million was from the bank's own funds and EUR 1.5 million was EBRD credit.

3.6 As a result of the annual growth in demand for short-term credits in Bulgarian agriculture, in the forthcoming autumn (2002) two or three more commercial banks are intending to join this credit system. This is likely to result in an increase in the amount of farmers' credit and in a reduction of the annual interest rate on credits extended. The annual interest rate on credits extended in the year 2001 constituted 11–12 percent, and this year (2002) the interest rate should decrease to 8.5-10.0 percent.

3.7 Entities wishing to receive bank credit are obliged to meet rather high requirements, in that they must be free of any outstanding liabilities towards the state's budget and social insurance inspectorate. In the case that they are not free of such liabilities, the bank is required to deduct the amount owed from the short-term credit facility and transfer these funds to the accounts of the state budget or social insurance inspectorate for discharge of the accrued liabilities. In addition, the total amount of a credit extended to one entity is not allowed to exceed EUR 200,000.

3.8 Although farmers are entitled to repay their credits earlier, in many cases the grain growers fail to repay their bank credits even in the same year as they acquire them. For instance, in the year 2000, almost all the credits were repaid only in January to February of the subsequent year, and the dates of repayment of credits taken out in the year 2001 had to be extended until April, as a result of a higher grain supply in the market than

in the previous year. However, there have been no cases of default yet. In the year 2001, the bank allocated more than BGL 2.5 million (approximately LTL 4.8 million) for the purpose of this credit system and, in the future, it is intending to allocate even higher amounts, specifically designated for farmers' credits. The Law on Grain Warehousing and Trade of Bulgaria establishes a separate procedure for recovery of outstanding credits, which differs from that of the Civil Code of Bulgaria. The grain pledge certificate is not required to be registered with the mortgage register. According to the Law, the bank has to perform the recovery procedures on its own. If the value of the pledge security falls below 125 percent, the bank may claim from the borrower an additional security in the form of money or real estate. Farmers who possess appropriate warehouses for keeping grain may also acquire the status of licensed warehouse and keep in custody both their own and other farmers' grain. After having pledged the grain kept in their licensed warehouses to the bank, such farmers may be extended a short-term credit for the purpose of working capital under the same conditions.

3.9 The warehouse receipt system in Bulgaria works on the basis of the Storage and Trade in Grain Act. The Act regulates the conditions of grain storage and trade, the powers of state bodies, and the rights and obligations of natural and legal persons performing such activities. One of the major purposes of the Act is to create conditions for:

- steady development of grain production and grain processing;
- stabilization of the grain market in the country; and

- provision of grain reserves for the purpose of overcoming difficulties in supply.

The strategic grain reserve

3.10 Pursuant to the Law, a strategic grain reserve shall be established, stored and managed by the State Reserve and Wartime Stock General Directorate. The reserve shall be intended for the provision of state demands in the event of events of irresistible force but shall not constitute wartime stock.

Public grain stores

3.11 Public grain stores shall act as merchants responsible for the storage of deposited grain and issuance of store notes, as well as joint-stock companies or limited liability companies acting on the basis of the Commerce Act. The Act sets minimum requirements for public grain stores. First, the minimum capital required to set up a public grain store shall be BGL 100,000,000. Second, public grain stores shall possess storage capacity of not less than 3,000 tons of grain. Third, under the Act, public stores shall present a deposit or an irrevocable bank guarantee in the amount of BGL 10,000 for every ton of their storage capacity in favor of the Ministry of Agriculture, Forestry and Agrarian Reform. The term of the deposit and of the bank guarantee shall not be less than two months after the termination of the license. Moreover, public stores for grain deposit shall set up compensation funds to guarantee depositors' claims.

3.12 The Act also sets forth some restrictions for public grain stores:

- public grain stores may not be warrantors, they may not lodge collateral and be guarantors on loans of third persons;
- public grain stores may assign property rights on their storage premises and take mortgages on them only with the permission of the licensing body; and
- public grain stores and granary managers shall be obliged to insure the storage premises against fires, floods and earthquakes.

Licensing

3.13 Public grain stores and granaries shall be licensed by the Minister of Agriculture, Forestry and Agrarian Reform at the proposal of the National Grain Service. The Minister of Agriculture, Forestry and Agrarian Reform shall modify or suspend licenses of public grain stores or granaries at the request of the public store, the owner, or the leaseholder of the granary, or at the request of the National Grain Service. The conditions for licensing are established by the special secondary legislation act.

Store notes and grain deposits

3.14 Pursuant to the Commerce Act, store notes of grain deposits shall be promissory securities, issued by the public grain store and proving the deposit of grain and the obligation of the store to return the deposit to the legitimate note holder. Public grain stores shall issue store notes to the extent of their capacity, and these shall be store notes within the meaning of the Commerce Act. The store notes of grain deposits shall be issued on the basis of the store register and shall consist of two parts: notes of commodity

and notes of collateral. These notes of commodity and notes of collateral for deposits of grain shall be promissory securities.

3.15 In addition to the special provisions of the Commerce Act, both parts of the store notes of grain deposits shall also contain details of:

- the value of the “Store note of grain deposit”;
- the location and number of the granary in which the grain is stored; and
- the harvest year and the grain quality.

3.16 Store notes of grain deposits shall be issued by public stores on the basis of a protocol of grain receipt, reflecting its type, quantity, quality and condition. Store notes and notes of commodity for grain deposits may be subject to trade, including trade on the commodity exchange. Notes of collateral for grain deposits shall serve to collateralize the deposited grain when receiving a loan, and may also be traded in the capital market. Store notes of grain deposits and the parts thereof shall be transferred only by way of full endorsement.

3.17 When the identified holder of a note of commodity receives the deposited grain, the public grain store shall be obliged within two days to notify the last known holder of the associated note of collateral of the amount of deposited grain received. When the holder of the note of commodity has endorsed the note of collateral, he/she shall be obliged within two days to inform the endorsee (the holder of the note of collateral). All further endorsers on the note of collateral shall have the same obligation. In the case of default of this obligation, the endorsers of the note of collateral shall be liable for damages incurred before its holder. When the holder of the note of collateral for grain deposit does not receive the amount

on the note within three days of its being lodged under the usual procedure of the Commerce Act, he/she shall be entitled to demand sale of the grain deposited in the public store. The same right shall also be held by any endorser who has paid the holder of the note of collateral and has entered into his/her rights.

3.18 The sale of deposited grain shall be effected by the public store following the procedures established by the Commerce Act after expiry of the term agreed, and at the written request of the holder of the note of collateral.

3.19 Claims shall be satisfied in the following order out of the amount received from the sale of the grain:

- taxes, duties and expenses on the sale;
- remuneration of the public store and unpaid expenses, entered in the store note;
- the creditor's claim on the note of collateral;
- other claims of the public store; and
- the claim of the holder of the note of commodity.

Hungary

General

3.20 In Hungary the system of licensed warehouses is highly developed. At present it has the potential to cover almost half of the annual grain yield. Enterprises entitled to store grain in licensed warehouses must meet extremely high requirements: their registered owner's equity is required to constitute no less than HUF 500 million (approximately LTL 7.4 million). At least 50 percent of the fixed amount required for owner's equity must be registered prior to submitting an application for a warehousing certificate. An in-kind contribution in the form of real estate must constitute at least HUF 250 million within the structure of the registered owner's equity in a public company. This condition remains effective throughout the entire period of operation of a licensed warehouse. Only by three major enterprises currently meet these strict requirements.

3.21 Only 20 percent of Hungarian grain is stored in warehouses owned by these three major licensed enterprises; approximately 80 percent is stored in the private warehouses of grain growers. Each grain grower whose warehouse meets the above requirements may acquire the right to provide such a warehouse on lease to one of the aforementioned three licensed enterprises. Such enterprises have to enter into agreements with the grain growers under which they may store grain produced by themselves or by other farmers.

3.22 The Lithuanian delegation visited one of the three major enterprises, the state enterprise *Concordia*. This enterprise stores grain in its own warehouse and in the warehouses of grain growers. The enterprise has warehousing capacity of 400 thousand tons; however, the annual

warehousing turnover constitutes approximately 650 thousand tons of grain. The enterprise possesses advanced, efficient equipment designated for the cleaning and drying of grain, which allows it to accept grain directly from the harvester–threshers and prepare the production in full. About one million tons of grain is stored by the enterprise in farmers' private warehouses that meet the requirements of licensed warehouses. If the grain produced by a farmer complies with the standard, such a farmer may have his own grain stored in his own warehouse together with the grain of other farmers and may receive warehousing instruments (warrants) for a short-term credit from a commercial bank. Although the growers who take custody of grain in their own warehouses are held fully liable for the preservation and quality of the grain, the specialists of *Concordia* exercise frequent control over such warehouses and inspect the quality of the grain in store.

3.23 Upon delivery of the grain to the licensed warehouses, the grain growers are issued warehousing instruments (warrants) consisting of three parts. A copy of a warehousing instrument is retained by the warehouse (enterprise), while the grain owner is issued a warehousing and pledge certificate, which may be submitted to a bank if the grain owner wishes to receive a short-term credit. Pursuant to Hungarian law on warehouses and warehousing documents, a bank has the right to retain only the pledge certificate, while the warehousing certificate must be returned to the grain grower. In practice, however, the situation is different. Banks usually also retain the warehousing certificate in an effort to have more sound guarantees. As soon as the grain is purchased and the credit is repaid, together with the interest accrued thereon, the bank transfers the pledge and ownership certificates to the grain purchaser. In the event that a farmer fails

to repay the credit, the bank, three to five days prior to the date that the repayment of credit falls due, instructs the licensed warehouse to sell the borrower's grain, and to use the amount received for reimbursement of costs incurred by the warehouse for warehousing services and to repay the bank credit along with the interest accrued.

3.24 When extending credits to farmers or to the processing enterprises, the bank supervises their credit histories and extends credits to reliable clients under better terms. In the year 2001, farmers in Hungary were able to receive credits from commercial banks totaling HUF 80 billion (or LTL 1.18 billion) against the warehousing instruments. When a client is unable to produce sufficient security for the credit, one of the two existing Guarantee Funds may furnish a guarantee to the bank in the amount of 50 percent of the credit extended.

3.25 Commercial banks in Hungary willingly participate in this crediting scheme since grain is a highly marketable product, both in the domestic and external market, and it does not tend to decline in quality during the warehousing period. Short-term credits are usually issued by the bank for three to twelve months. As a rule, grain growers take short-term credits for five to six months, and by February of the following year such loans are repaid with interest. Annual interest is comparatively high (approximately 12 percent), but 9 percent of the amount accrued by December 1 of the current year is covered by the state, while 4 percent of interest accrued is covered by the state on the credits that are repaid later. This procedure also applies to wheat growers and to grain processing enterprises, which purchase wheat from growers in large quantities. Interest on credits is also covered by the state for foodstuff producers and mills that purchase grain stock for manufacture within three months. Each year, banks

check the reliability of the licensed warehouses, and establish limits for guarantee issuance in respect of the following year's yield.

3.26 Pursuant to Act XL VIII of 1996 on Public Warehousing, a public warehouse is an economic organization where goods may be deposited on the basis of a contract, for the purpose of safe custody and public warehousing. Following the Act, the warrants of a warehouse are securities made out to order, issued with respect to the goods taken into deposit on the basis of a warehousing contract, which represents the acknowledgement of the receipt of the goods by the public warehouse and proves its obligations for releasing them.

3.27 A public warehouse may operate exclusively as a company limited by shares, to which the provisions of Act VI of 1988 on Economic Associations shall apply, while taking account of the differences contained in this Act in comparison with those of the 1996 Public Warehousing Act. A public warehouse shall own registered capital (issued capital) of at least HUF 500 million.

3.28 It should be noted that a public warehouse might borrow exclusively for a purpose connected directly to the conducting of public warehousing activity, and may allow an exclusive lien on its property items for the purpose of guaranteeing the same. A public warehouse may not undertake surety for the repayment of the debt of a third party.

Licenses

3.29 A public warehouse founded in accordance with the provisions of the 1996 Public Warehousing Act and entered in the companies register may perform public warehousing activities if licensed by the Minister of

Industry and Trade (hereinafter the Supervision Agency) with the agreement of the State Banking Supervision, and if the public warehouse has been registered. A relevant special license is also required for the operation of the public warehouse in a duty-free zone.

Personal conditions to the management

3.30 The management of a public warehouse shall be carried out by a person with adequate qualifications who is employed by the public warehouse. Only a person with a clean criminal record, higher education, and a relevant trade practice of at least three years may be appointed to manage a public warehouse, provided that he/she has no public debt established by a non-appealable decision.

State supervision of public warehouses

3.31 The supervision of public warehouses shall be performed by the Minister of Industry and Trade. Its duty in this sphere is to license public warehousing activity in the interest of public confidence, and to supervise the fulfillment of the obligations of the public warehouse, as prescribed in the 1996 Public Warehousing Act and in other relevant legal rules, on a continuous basis. The Supervision Agency shall supervise/check annually, in co-operation with the State Banking Supervision, that the conditions of public warehousing activity are satisfied, as prescribed by law, and by the practice of public warehousing and granting of loans (general supervision). In addition to general supervision, the Supervision Agency may order further investigation extending to certain fields.

Definition of the warehouse contract

3.32 On the basis of the warehouse contract, a public warehouse is obliged to safeguard provisionally the goods deposited with it, and to issue a respective warehouse warrant, while the depositor is obliged to pay a warehousing fee. To be valid, the contract must be in writing. In the case that the public warehouse fails to issue a warehouse warrant covering the goods deposited, the transaction shall constitute a deposit as referred to in the (Hungarian) Civil Code.

Subject matter and contents of the warehouse contract

3.33 Only goods that do not jeopardize personal and property security, or the other goods deposited in the public warehouse, may be the object of a warehouse contract.

3.34 A warehouse contract may only be made for a definite period of time, not exceeding one year, and its period may not be extended. In the case that the goods are not sold following the expiry of the contract, the holder of the warehouse warrant and the public warehouse may conclude a new contract. In such a case, the warehouse warrant issued on the basis of the previous contract shall be withdrawn and invalidated.

3.35 On the basis of the agreement of the parties involved, public warehousing may take place in the manner that the goods are stored, either:

- separately from other goods; or
- mixed with replaceable goods of the same type of other depositors.

3.36 It should be noted that public warehouses are obliged to prepare business regulations and a tariff of fees and to make these public in premises open to clients.

The liability of public warehouses

3.37 Public warehouses shall be liable for damage caused to goods placed in public warehousing from their receipt until their release, and particularly for their total or partial loss, destruction, spoilage or damage, unless they were caused by:

- an unavoidable reason outside the sphere of activities of the public warehouse;
- the internal characteristic features of the goods (their natural quality);
- a latent defect of packaging; or
- conduct attributable to the depositor or to the person acting on his/her behalf

The warehouse warrants

3.38 The warehouse warrant constitutes the coupon part of the deposit register kept by the public warehouse according to serial number and in chronological order, and consists of two connected but separable parts, i.e., the docket and the lien warrant, which contain the same data master page that remains in the deposit register.

- 3.39 Both parts of the warehouse warrant shall contain the following:
- a. the name of the warehouse warrant (docket-lien warrant), in the language of issuance of the document;
 - b. the name of the public warehouse;
 - c. the serial number of the deposit register;
 - d. the name, head office (place of residence) of the depositor;
 - e. the description, quantity, quality and value of the goods deposited;
 - f. the amount of outstanding claims from the warehousing fee and from fees for other services stipulated in the warehouse contract;
 - g. the duration of public warehousing, indicating the exact date of expiry;
 - h. the place of storage, and indication of subcontract storage, if applicable; and
 - i. the date of issuance and the corporate signature of the public warehouse.

Transfer of the warehouse warrant

3.40 The transfer of the warehouse warrant or any part thereof may be effected through endorsement: the statement of transfer written on the back of the warrant, with the (corporate) signature of the transferor. The endorser is the transferor of the warehouse warrant or a part thereof, while the endorsee is the person acquiring the warehouse warrant or a part of it. A statement of transfer where the endorsee is not defined shall be considered to be a blank endorsement. The holder of the warehouse warrant is identified and confirmed by the connected chain of endorsements on the

reverse; a blank endorsement shall be considered valid. The endorsement of warehouse warrants is not a public warehousing activity. The holder of the warehouse warrant may raise a loan by endorsing the lien warrant. A duly endorsed lien warrant itself constitutes the cash claim for the amount indicated on the lien warrant, and as a security, it provides a lien to its holder with regard to the goods placed in the public warehouse.

3.41 In the case that the transfer of the lien warrant is effected separately, the first endorsement shall contain the following:

- a. the name, head office and bank account of the lender;
- b. a fixed sum of money enforceable (collectable) upon the expiry of the loan which also includes the interest calculated until the expiry of the loan;
- c. the due date of the repayment of the loan (date of expiry);
and
- d. the name and head office of the first lien warrant endorser who raises the loan.

The lien loan

3.42 Following the issuance of the warehouse warrant, the public warehouse may extend a loan to the holder of the warehouse warrant for up to two-thirds of the value of the goods. The lien warrant shall be endorsed to the public warehouse in order to secure the loan. The aggregate amount of lien loans extended by the public warehouse may not exceed five times the equity capital of the public warehouse.

Release of the goods

3.43 The public warehouse is obliged to release the goods placed with it, to whoever

- returns the docket and the lien warrant to it, or
- returns the docket and deposits the amount of claim indicated in the lien warrant with the public warehouse, provided that the amount of value-added tax generated by virtue of the release as product sale has been deposited with the public warehouse to the credit of the depositor.

3.44 The release shall not constitute a product sale if the depositor and the applicant for release are the same person. The public warehouse is obligated to keep the amount deposited in a separate account, and, within two days, to notify the last holder if the lien warrant known to it of the deposition. In the case that the holder of the lien warrant has already re-endorsed the lien warrant, he/she shall notify the endorsee within the additional two days of the notification by the public warehouse, and the same obligation shall apply to all further endorsers of the lien warrant. The endorsers of the lien warrant shall assume liability towards the holder of the lien warrant for any damage caused by the neglect of this obligation.

3.45 The public warehouse is not obliged to examine the genuineness of the endorsements on the reverse of the warehouse warrant, only to check whether or not the connected chain of transfers identifies and confirms the holder of the warehouse warrant.

3.46 The public warehouse is obliged to issue the goods to the holder of the warehouse warrant, if the latter has satisfied the claims indicated on

the warehouse warrant. Otherwise, the public warehouse may sell the goods and divide the amount received in accordance with the provisions of the law. The public warehouse shall notify the depositor, simultaneously with the release of the goods, of the date of release, and of the data required for the settlement of sale, value added tax and excise. This date shall be the date of performance of the sale of products originating from the depositors of the goods.

3.47 The public warehouse may enforce any claims arising from the warehouse contract towards the holder of the warehouse warrant or the docket. The endorsers may only enforce their own claim towards the public warehouse, and may not enforce the claims of any endorsers preceding them. Within this sphere, the claims of the public warehouse and those of the holder or holders of the warehouse warrant or any part thereof may be offset against one another.

3.48 In the case that the amount of the loan indicated on the lien warrant is not paid to the holder of the warrant at the time of expiry, the holder of the lien warrant shall have this fact established by the end of the second business day following the date of expiry, by means of the statement of acknowledgment of the first endorser of the lien warrant, entered on the lien warrant, or by means of a notarial instrument (protest). Failing either of these actions results in losing the right of recourse; however, the protest is not a condition for the holder of the lien warrant in requesting the public warehouse to sell the goods.

3.49 If the amount indicated on the lien warrant is not paid to the holder of the lien warrant within three days following the date of expiry, the holder of the lien warrant may demand the sale of the goods placed in the

public warehouse, and the satisfaction of his/her claim from the purchase price. The same right shall be due to the first endorser towards the holder of the docket, if the lien warrant is redeemed.

3.50 In the case that the holder of the lien warrant had a protest noted, he/she may also enforce the expenses incurred with respect to this protest, together with any claim on the payment of the amount of loan. A certified copy of the invoice(s) pertaining to the expenses of the protest shall be submitted to the public warehouse. In the case of sale, the expenses of the protest shall be reimbursed from the purchase price received, together with, and with the same priority as, the amount indicated on the lien warrant.

3.51 The amount received as a result of sale shall be paid in the following order of priority:

- a. fee claims of the public warehouse entered in the warehouse warrant;
- b. claims of the holder of the lien warrant;
- c. other claims of the public warehouse; and
- d. claims of the docket holder, and if the latter stays at an unknown place, the money due to him/her shall be deposited in the custody of the court.

3.52 If the goods must be sold, and the goods meet the conditions contained in the regulations of the Budapest Commodity Exchange, the public warehouse shall sell the goods at the Commodity Exchange, in accordance with the provisions of the regulations of the Commodity Exchange applicable to the forced sale of warehouse goods.

3.53 If the goods cannot be sold at the Commodity Exchange, or if the sale fails on seven consecutive Commodity Exchange days, the goods shall be sold by auction. The buyer shall acquire title in the case of sale either at the Commodity Exchange, or by auction, even if the depositor was not the owner of the goods.

Execution, bankruptcy, proceedings and liquidation

3.54 The goods deposited in a public warehouse may not be seized in the course of execution by the court, and are not included in the assets defined in the Act on Bankruptcy, Proceedings, Liquidation Proceedings and Final Accounting. However, the docket and the lien warrant, as securities, may be seized in the course of a court execution, and shall also be taken into account when the assets referred to in the Bankruptcy Act are determined. When the sale takes place in the course of execution by the court, the minutes drawn up by the bailiff shall replace the endorsing statement.

3.55 In the case of bankruptcy proceeding of the holder of the docket, the moratorium and the settlement with creditors shall not apply to the holder of the lien warrant. If his/her claim is not satisfied by the first endorser of the lien warrant, the holder of the lien warrant may request satisfaction on the basis of this Act, following the date of expiry, from the amount received in the course of the sale of the goods.

3.56 The bankruptcy proceedings of a first endorser of the lien warrant shall not prevent the enforcement of the claim based on the lien warrant, but the moratorium and the settlement with creditors shall also apply to the holder of the lien warrant with respect to the right of recourse. The bankruptcy proceedings of the first endorser of the lien warrant shall

not prevent the enforcement of the claim against the endorsers preceding the holder of the lien warrant.

Summary of the findings from Bulgaria and Hungary

3.57 A new crediting system for farmers and processing enterprises launched in Bulgaria and Hungary, which uses grain and other agricultural products as security, has justified itself in full, and brought about positive results. For example, upon having established licensed warehouses for common use and a warehousing certificates (receipts) system, agricultural producers and processors in Bulgaria and Hungary may, by using grain and other products as security, apply to participating commercial banks for short-term credits. This new crediting system in the two countries facilitates mutual settlement between farmers and processors, and increases the circulation of money in the agricultural and processing industry sectors. Commercial banks use pledge certificates against grain or other agricultural products as security to extend short-term credits for from three to twelve months (70–80 percent of the value of warehoused grain) with 10–12 percent annual interest. Farmers are compensated for 50–70 percent of warehousing expenses. Subsidies for interest are being paid, but do not exceed 5 percent.

3.58 The most important thing in establishing this advance system is the creation of a proper foundation in the law

3.59 Experience in the two countries visited shows that the situation in the grain market and the financial situation of the farmers may be improved without large state investments.

3.60 Since laws on licensed warehouses, warehousing instruments, and other regulatory enactments have been adopted, trust in the system has improved. Commercial banks in these countries have extended credits to farmers and processing enterprises using grain or other agricultural products as security.

3.61 Farmers in Bulgaria and Hungary, before having sold their production, pledge grain or other agricultural products to banks, and take short-term credits that are utilized for settlement with their suppliers, etc.

3.62 The system contributes to a wider money circulation in the agricultural and processing industry sectors.

3.63 Compensation Funds have been established in Bulgaria and Hungary, and the governments of both countries have participated in their establishment and financing.

3.64 Both countries have a flexible system of debt recovery.

4. RECOMMENDATIONS FOR IMPROVEMENTS IN LITHUANIA

General

4.1 For the implementation of the system of common-use warehouses and warehousing receipts in Lithuania, it is necessary to adhere to the following structural organization model:

- (1) Creation of a proper legislative environment through:
 - (a) revision of Lithuanian laws and other statutory acts pertaining to the creation of the system of licensed common-use warehouses and warehousing certificates, and harmonization thereof with the new Civil Code; and
 - (b) co-ordination of legal acts of Lithuania related to implementation of the system of the licensed common-use warehouses and warehousing certificates with the legal acts of the EU.
- (2) Co-ordination of interests among growers, agricultural processors and traders.
- (3) Proper insurance of the financial institutions (commercial banks) providing short-term loans against bankruptcy of warehouses.
- (4) The formation of a guarantee fund and insurance of common-use warehouses and goods in store.

- (5) The establishment of a state supervisory and control system.

Requisite conditions for the successful implementation of a crop receipt system

- (1) An appropriate legislative environment.
- (2) The costs of growing and sale of agricultural products (crops) at least 10 percent lower than the crop purchase price offered by the purchasers-processors, if possible.
- (3) Technically and technologically smoothly functioning common-use warehouses.
- (4) Licensing of common-use warehouses and regular inspection (control) of their activities.
- (5) A well-functioning system of guarantee insurance (reserve insurance fund) as well as the insurance of warehouses and goods in store.
- (6) Commercial banks to participate fully in the crediting of the system.

4.2 For successful introduction of common-use warehouses and a warehousing certificate system, the points below give a more precise description of the conditions listed above:

- (1) The most important matter in the implementation of the system of common-use warehouses and warehousing certificates is the creation of a proper legislative environment, i.e., revision of the existing laws and other statutory acts of Lithuania and the

adoption of new legislative deeds as well as the co-ordination thereof with EU directives.

- (2) The appropriate legislative environment has to ensure a sound functioning of the guarantors' (insurance) system in order to induce the commercial banks to take an interest in extending short-term loans to the growers and processors of crops (and other commodities). The current legislative framework, namely, the rules enshrined in the Lithuanian Civil Code, does not provide for any guarantees and/or insurance (the Civil Code only states that the law or the contract may establish an obligation to insure the pledged item); therefore, the current laws do not accomplish the required objective. The new draft law puts public warehouses under an obligation to insure the property in which agricultural commodities are stored against fire, natural forces and other damage, for a sum not less than the value of the whole-insured property. Additionally, a public warehouse must insure its liability for the term of a license. Furthermore, pursuant to the warehousing agreement, the commodities accepted into custody under the double warehousing certificate must be insured against the risk of loss or deterioration. Finally, the draft law states that a Reserve Fund shall be established with the aims of (i) securing the claims of creditors (arising from the crediting relationship), and (ii) securing the interests of the owners of the goods with respect to the possible loss of the commodities not compensated by the relevant insurance company. The Government of Lithuania shall approve the rules regulating the creation, the administration and usage of the Fund as well as the institution

administering the Fund. Furthermore, one of the income sources of the said Fund is the assignment from the state budget, allotted to the Ministry of Agriculture. Consequently, the draft law establishes the basis for a guarantee (insurance) system which should be sound enough to attract banks to participate in this credit system.

- (3) The warehousing certificates have to explicitly define the rights, duties and liabilities of each party (crop grower, warehouse, crop processor and the bank). Warehousing agreements shall be executed in warehousing documents, i.e., a double warehousing certificate or an ordinary warehousing certificate. The draft law states that the rules on storage of commodities are an integral part of the warehousing agreement. The said rules establish the conditions under which the commodities are taken into custody, the conditions of storing, fees for the services, etc. The warehousing certificate itself shall include information on the quantity and quality of commodities and shall identify the parties to warehousing agreement, the term of storage, the fees, information about the insurer, and the date. The draft law, although leaving the right to regulate strictly the rights, obligations and liability of the parties in the agreement, does not enshrine an obligation to do so. Thus, the desired minute definition of the rights and responsibilities of crop grower, warehouse, crop processor and the bank shall be included in the documents of warehousing more because of common practice than because of the strict regulations of law.

- (4) The new law would accelerate the circulation of crop ownership rights (documents) among all the parties participating in the credit transactions, enhance their mutual confidence, and simplify the extension and administration of short-term credits to farmers and crop processors.
- (5) The law must be co-ordinated with the existing legal base: the new Lithuanian Code on Civil Proceedings, and other laws and legislative deeds.
- (6) The smoothly functioning guarantee system is based on pledges against crops or other products kept in common-use warehouses.
- (7) The operation of the common-use warehouse must be licensed and regulated by law. The existing Civil Code outlines general principles on warehousing agreements and forms the basis for the financing of warehouse receipts, rather than the regulation of the operation of warehouses. Although the new draft law addresses this issue by stating the rights and obligations of warehouses and the licensing conditions for them, it is bound to be followed by secondary legislation regulating the operation of warehouses in a more detailed manner, if the system of grain warehousing and crediting of warehouse receipts is to function properly. The existing Civil Code does not delineate such a requirement, thus the current law does not sufficiently regulate the issue. However, the draft law specifically addresses the issue by stipulating that only licensed warehouses shall have the right to participate in this crediting system. Article 5 of the said draft law enshrines the requirements for warehouses seeking to obtain

a license. In addition, after the draft law is adopted, the Government of Lithuania shall be instructed to adopt warehouse Licensing Regulations.

- (8) Oil-bearing crops (e.g., rape), leguminous crops, food potatoes and seed potatoes of late crops are recommended for storage in licensed common-use warehouses. The goods kept in licensed common-use warehouses must be stored according to their designation, i.e. food grain is to be kept separately from forage grain, etc. The draft law includes the requirement that licensed common-use warehouses store the commodities in accordance with the laws and regulations. They should be stored separately according to their grade, supposed manner of usage, and quality characteristics.
- (9) The licensed common-use warehouses must satisfy the legal requirements from organizational, technical, and technological (crop drying, cleaning, sorting and preservation of the quality needed) viewpoints, as well as from the standpoint of public announcements of business conditions. Licensed common-use warehouse function in an unbiased role in aiding in the realization of goods in store and the pledge certificate. One of the requirements for warehouses that should be met in order to obtain the license is sufficient preparation for the storage of grain, i.e., the technical, technological and other conditions of warehousing should be not lower than those established by the special requirements adopted by the institution authorized by the Government. Should a warehouse fail to meet these requirements, it shall not be granted a license. The provision of

the draft law is sufficient to ensure the implementation of this precondition.

- (10) Insurance of the licensed common-use warehouses is mandatory in order to make certain the protection of goods in store as well as the validity of the rights, duties and liability of the warehousing certificates issued, until full finalization of the cycle. The current law, namely, the Civil Code, entitles the parties to insure the item pledged rather than putting an obligation upon them to do so. Such regulation is not sufficient to secure the rights of the creditors and might be cited as one of the weaknesses of the present legal regulations. The draft law successfully deals with the question, as it places both the warehouse and the owner of the commodities under a legal obligation to insure against fire, natural forces and other possible damage. Commodities that have not been insured shall not be accepted into custody, and the warehouse shall not be granted a license if it has not insured the warehouse property and its civil liability.
- (11) The warehousing certificate is a traditional security that might be continuously assigned to other persons. Both the current law and the draft law provide for the possibility of continuously assigning rights under a warehouse receipt.
- (12) The holder (farmer or processing company) of the warehousing certificate (i.e., the ownership) has the right to redeem the pledge certificate from the financial institution (commercial bank) that has extended it a credit. Neither the current legislation nor the

draft law restricts the right of the owner to redeem the pledge certificate from the financial institution as long as he/she fulfills the obligation, i.e., repays the credit to the bank together with the interest accrued thereon.

- (13) In order to satisfy its lawful claims, a common-use warehouse has preemption right over other persons to a crop in store. The warehouse does not release the crop in store to farmers or purchasers/processors until payment has been received in full for the storing of crops and other services rendered. The draft law grants a common-use warehouse the right of retention of the commodities in custody if the owner of the goods fails to pay for the storing in due time. The goods shall be released only upon full payment for the services of the warehouse concerned.

Summary of the draft law presented

4.3 The new Law will be composed of four sections: “Section I. General Provisions”; “Section II. Licensed Warehouses”; Section III. Acceptance and Release (Return) of Goods. Warehousing Instruments”; and “Section IV. Final Provisions.”

4.4 Section I of the Law will establish the purpose and scope of the Law, the main definitions concerned, and the kinds of goods that are subject to the law (recommended crops for storage include maize, seeds and non-seed crop parts of oil-bearing (e.g. linseed) and leguminous plants, food potatoes of the late type, and fruit and vegetables).

4.5 Section II of the Law will set the operating conditions of warehouses that could participate in the crediting system to be formed by a

draft law for which provision has been made. The operation of the warehouses will be licensed and regulated by legislative deeds. The licensing regulations will be approved by the Government of Lithuania. The licensed warehouses will have to meet the organizational, technical and technological (e.g., drying, cleaning, sorting and proper quality preservation) requirements. They will have to announce the warehousing regulations publicly in order that the owners of goods and the commercial banks will be able to rely on them (i.e., that there are the proper assurances that the crop will be appropriately stored, that it will not disappear, and that the quality thereof will not suffer). The rights and obligations of a licensed warehouse as well as the control of its activities will also be established. The insurance of the licensed warehouses and of the goods stored is mandatory in order to ensure the security of the goods in store and the validity of the rights, obligations and liability assumed under warehousing instruments until full close of the cycle. For the assurance of the rights of claim of commercial banks arising out of the crediting relations, and for the interests of the owners of the goods stored in respect of the possible loss of such goods, in as far as such loss is not provided for by the conditions of a standard insurance contract, it is necessary to form a Reserve Fund. The procedure for the formation and use of the Reserve Fund will be established by the Government of Lithuania or by an institution authorized by it.

4.6 Section III of the Law will deal with the conditions and procedure for acceptance and release (return) of goods, the issuance and transfer of warehousing instruments (double warehousing certificates and ordinary warehousing certificates), the satisfaction of claims based on relevant warehousing instruments, as well as other rights and obligations of the holders of the warehousing instruments. The right to issue double

warehousing certificates and ordinary warehousing certificates will be vested solely in the licensed warehouses. An ordinary warehousing certificate, a double warehousing certificate and its separate parts (the warehousing certificate and the pledge certificate) are qualified as securities. Their pledge will enable the owner of the goods to obtain short-term loans, whereupon the lender will be granted pledge rights for the goods in store. The goods in store will not be released until full settlement is rendered to the licensed warehouse for the warehousing and other services, together with the submission of all the requisite warehousing documents. Should the owner of the goods fail to repay the loan that is secured by the relevant warehousing documents when it is due, the holder of the pledge will have the opportunity to satisfy its claim from the value of the goods pledged. The detailed regulations for the use of the warehousing instruments will be approved by the Government of Lithuania.

4.7 Section IV of the Law will set the effective date of the law and make a proposal to the Government of Lithuania to draft the legislative deeds requisite for the implementation of this law.

Particular proposals

4.8 Paragraph 1 of Article 2 in the original version of the draft law stated that: “A licensed warehouse is a company (businessman), which [that] obtained a license to engage in warehousing activity in accordance with this law”. A proposal has been made to delete the word “businessman” here. The opinion was that only legal persons in stock corporations might engage in the activities of licensed warehouses.

4.9 Article 2 (The main concepts of the law) of the draft law defines warehouse documents as follows: “[an] ordinary warehouse certificate, double warehouse certificate or any part thereof (i.e., warehouse certificate or pledging certificate) are documents that certify certain rights to the commodities and which are issued in accordance with this law.” A proposal has been made to supplement Article 2 of the draft law with an explanation of the concepts “ordinary warehousing certificate” and “double warehousing certificate.”

4.10 Paragraph 17 of Article 2 of the original draft states that: “the Reserve Fund is [a] monetary fund formed in accordance with this law, designated to secure the interests of the owners of the commodities and interests of the creditors from loss or deterioration of commodities, that are not compensated by the insurance company or warehouse, and from the possible bankruptcy of the warehouse.” Owing to the fact that it is not clear what kind of loss the owners of goods and the creditors may sustain due to the bankruptcy of a warehouse, it is proposed to delete the words “and from the possible bankruptcy of the warehouse.”

4.11 Paragraph 3 of Article 1 states that the rules of other laws shall be applied to the relations regulated by this law only in as much as they are not regulated by special law. However, it is not expedient to specify that this new law is “special” – the issue of application of other legal acts should be solved by taking into account the subject matter of both this law and the purpose of other legal acts.

4.12 The definition set forth in Paragraph 16 of Article 2 is subject to revision since it states that the warehousing regulations shall be approved prior to the issuance of a license, whereas a sole enterprise/businessman,

being the holder of a license, i.e., a licensed warehouse, may be also be allowed to engage in warehousing activities.

4.13 Paragraph 2 of Article 4 of the draft law, which states that the warehouse licensing regulations for certain commodities or groups of commodities that are adopted by the Government of Lithuania or its authorized institution, are subject to revision, since the licenses are issued to certain kinds of business activities rather than to goods or to groups of goods. It is proposed that only activities performed under this law should be licensed, and that the law should not prohibit other warehouses from acting without licenses, rather that non-licensed warehouses should not be part of the crediting relationship.

4.14 Article 5 of the draft law enshrines the requirements for the acquisition of a license. However, the documents requisite for the issuance of a license, as well as the procedure and terms of their consideration, types of licenses, license issuance conditions, cases of denial of licenses and other issues, as set forth in Part 2 of Article 2.78 of the Civil Code, should be regulated in the Licensing Regulations. It is, therefore, inexpedient to provide for partial separate issues that will be regulated in the Licensing Regulations, when these are already addressed in the Civil Code.

4.15 Paragraph 2 of Part 2 of Article 5 of the draft law sets place of business in the Lithuania as a precondition for the acquisition of a license. However, the concept “place of business is in the Republic of Lithuania” is unclear, thus it should be deleted from the draft law.

4.16 Paragraph 5 of Article 5 of the draft law states that a license for the enterprise/businessman shall be granted for unlimited duration with an obligation, set out in the Licensing Regulations, to reregister the granted

license in certain periods, as specified in the Licensing Regulations. This provision is subject to revision, since the Civil Code does not provide for the re-registration of a license.

4.17 The provision laid down in Paragraph 2 of Article 7 of the draft law puts an obligation upon the enterprise operating a warehouse to insure the property in which the commodities are held in custody against fire, natural forces and other damage. In addition, it must also insure all the commodities kept in the warehouse against fire, natural forces and other damage at the expense of the owner of the commodities. Such regulation is subject to revision, since the goods might have already been insured against all kinds of risks by the owner of goods, so it is then not necessary for a warehouse to have the goods insured for a second time at the cost and expense of their owner.

4.18 Article 11 of the draft law is also subject to revision. The term “warehouse” in Paragraph 1 has two meanings – the premises, and a person engaged in warehousing activities. Moreover, the acceptance of goods for custody in a warehouse/premises is related to the appointment of a warehouse employee as an entity, whereas, according to Paragraph 3 of Article 87 of the draft law, a warehouse should not be entitled to refuse to accept goods.

4.19 The change of a warehouse superintendent should not affect the warehousing activities as specified in Paragraph 2 of Article 12.

4.20 It is not expedient to specify in Paragraph 1 of Article 28 that the holder of warehousing instruments is required to report in person or through his/her authorized representative, since the regulation of representation relations is not an appropriate subject matter for this Law.

4.21 It is recommended that Paragraph 2 of Article 5 of the draft law be revised by establishing the possibility that a branch office of a foreign legal entity in Lithuania can engage in warehousing activities.

4.22 The main issue of concern of the law is how to protect the interests of the creditors. Commodities are sold by court bailiffs by operation of the Civil Procedure Code of Lithuania. In this case, however, a problem is encountered in that warehousing certificates, pledge certificates inclusive, with outstanding liabilities of the debtor, are not qualified as independent executive documents under Article 373 of the Civil Procedure Code. For this reason, the creditor (bank) should, following the common procedures under the law, submit a claim before the courts and only apply to court bailiffs for forced sale of such commodities pledged after a favorable court decision has been received. This might not be beneficial in the sense that no effective and non-complicated debt collection under the pledge certificates would be ensured, which appears to be one of the objectives of the present law most relevant to commercial banks. Another option is that the pledge certificate should be made equal to a chattel mortgage bond and as such made subject to one and the same legal regulations, it being understood that the certificate would be registered with the mortgage office and that any debts thereunder would be collected through a ruling of the mortgage judge. However, putting warehousing certificates on the market as the new instruments would have no sense since pledges of grain and other substances or raw materials under chattel mortgage bonds are possible and absolutely evident under the currently applicable laws.

4.23 Invoking Article 4.219, Item 5 of the Civil Code of Lithuania, grain or other commodities pledged might be sold by the bank as the

creditor in the manner agreed between the bank and the debtor, or they might be sold by auction. The draft law contains no special provisions as to the procedure for selling any commodities pledged, nor is there any expediency in including any such agreements between the parties in the warehousing certificate. Therefore, a situation where no agreement is reached between the parties, as to the manner in which the commodities should be sold in the event of failure by the debtor to repay the loan, seems to be quite possible. Moreover, that the future owner of any such commodities pledged (i.e. the holder of the warehousing certificate forming part of the double warehousing certificate) could then not even be known to the bank. Many questions and even disputes (e.g., regarding the minimum selling price for commodities, the payment dates, etc.) may arise between the parties in the course of the auction, as a result of which the holding of any such auction may develop complications.

4.24 On account of the foregoing, we suggest creating provision setting the basic principles for sale by auction of any commodities pledged. Such wording of the law would be in line with Article 4.219, Item 5 of the Civil Code, which provides that the commodities pledged may be sold by auction. Incidentally, the law might also provide for the possibility that the commodities warehouse, the owner of such commodities (debtor) and the bank agree among themselves in writing to set another procedure for selling such commodities pledged. In this case the time limit allotted for the said agreement to be made after the debt maturity date must be specified, and a clause of sale by auction must be consolidated in accordance with the laws for the commodities pledged, in the event of failure by the parties to enter into such agreement within the agreed time limit. Additionally it would be

advisable to approve special secondary legislation on the detailed procedures for sale by auction of any commodities.

4.25 In short, there is no need to amend the Civil Code. However, provisions on the basic principles for sale by auction of any commodities pledged, and for the possibility that the commodities warehouse, the owner of such commodities (debtor), and the bank, agree among themselves in writing to set another procedure for selling such commodities pledged should be included in the draft law, as well as secondary legislation specifying that the procedure should be sufficient to remedy the situation.

4.26 The secondary legislation to be approved in order to have the warehouse receipt system implemented is as follows:

- a. Licensing Regulations.
- b. Regulations on the Reserve Fund.
- c. Regulations on Quality Supervision Over Licensed Warehouses.
- d. Regulations on the Hygiene–Veterinary Requirements for Warehouses.
- e. Warehouse Technical Regulations.
- f. Regulations on Sale of Commodities by Auction.

ANNEX 1

**PROGRAMME FOR THE STUDY TOUR OF LITHUANIAN OFFICIALS
TO BULGARIA AND HUNGARY**

**PROGRAMME FOR THE STUDY TOUR OF LITHUANIAN OFFICIALS TO
BULGARIA AND HUNGARY**

**Grain Warehouse Receipts Programme
Study tour of representatives from Lithuania
20 - 25 May 2002**

TRAVEL TEAM LEADER: **Mr Rimantas Kausikas**
Tel.: + 370 2 391 070
Fax: + 370 2 391 060
E-mail: Rimantas_K@zum.lt

SOFIA, BULGARIA, 20-21 MAY 2002

CONTACT PERSON: **Ms Zaritsa Dinkova**
International Relations Department
Ministry of Agriculture and Forestry
55, Hr. Botev, blvd.
1040 Sofia
Tel.: + 359 2 985 11 245
Fax.: + 359 2 980 82 70
E-mail: zaritsad@yahoo.com

ACCOMMODATION: **HOTEL RODINA**
Bratia Bukston blvd. bl. 208
1618 Sofia
Bulgaria
Tel/fax: +359 2 955 92 37
Tel.: +359 2 955 99 83

BUDAPEST, HUNGARY, 23-24 MAY 2002

CONTACT PERSON: **Mrs Katalin Bakk**
Secretary General
Hungarian National Committee for FAO
Ministry of Agriculture and Regional
Development
Kosuth Lajos ter. 11
1055 Budapest
Tel.: + 36 1 301 41 27
Fax.: + 36 1 301 46 62
E-mail: katalin.bakk@fvm.hu

ACCOMMODATION: **HOTEL ORIENTAL**
Budapest 1135
Fay street 61
Hungary
Tel.: +36 1 239 2399
Fax: +36 1 239 2268

PROGRAMME

19 May

Arrival to Sofia

20 May

10:30 Ministry of Agriculture and Forestry
Intervention and Marketing Department
State Fund Agriculture

14:00 National Grain Service

May 21

09:30 SG Express Bank

11:00 Union Bank

14:00 A warehouse

22 May

Departure from Sofia / Arrival to Budapest

May 23

09:30 Ministry of Agriculture and Regional Development

Agricultural Market Regulation office

Department of Economics

14:00 Ministry of Economics

Warehouse Superintendence

May 24

09:30 Agrarian Intervention Centre

11:00 Kereshedelmi és Hitelbank

14:00 Concordia Warehouse Ltd.

25 May 20

Departure from Budapest

ANNEX 2

LIST OF PARTICIPANTS

LIST OF LITHUANIAN PARTICIPANTS

1. **Mrs. Angele Abakiene** – Chief Specialist, Grain Unit, State Seeds and Grain Administration at the Ministry of Agriculture;
2. **Ms. Irena Adomaityte** – Deputy Head of the state Seeds and Grain Administration at the Ministry of Agriculture;
3. **Mr. Algirdas Jonas Aleksynas** – Plant Growing Specialist, Chamber of Agriculture of Lithuania;
4. **Ms. Vitalija Cereskaite** - Chief Specialist, Grain Unit, State Seeds and Grain Administration at the Ministry of Agriculture;
5. **Mr. Adolfas Damanskis** – Head of Plant Growing Unit, Agriculture and Food Department, Ministry of Agriculture;
6. **Mr. Zigmantas Gavinavicius** – Head of Finance Unit, Economics and Finance Department, Ministry of Agriculture;
7. **Mr. Raimondas Guobys** – Consultant, Association of Lithuanian Grain Processors ;
8. **Mr. Rimantas Kausikas** – Head of Accounting Unit, Economics and Finance Department, Ministry of Agriculture;
9. **Mrs. Skaiste Knabikiene** – Chief Specialist, Law and Human Resources Unit, Law Department, Ministry of Agriculture;

10. **Mr. Feodoras Konosenko** – Director General, AB “Jonavos grūdai”;

11. **Ms. Rasa Rimkute** – Head of Grain Unit, State Seeds and Grain Administration
at the Ministry of Agriculture;

12. **Mrs. Regina Trubajeva** – Deputy Head, Economy sectors’ Unit, Budget
Department, Ministry of Finance.